

MARKET CONDUCT EXAMINATION REPORT
AS OF JUNE 30, 2004

State Farm Mutual Automobile Insurance Company
One State Farm Plaza
Bloomington, IL 61710

NAIC Group Code: 0176
NAIC Company Code: 25178
Colorado Company No.: 944

EXAMINATION PERFORMED
for the
STATE OF COLORADO
DEPARTMENT OF REGULATORY AGENCIES
DIVISION OF INSURANCE

**State Farm Mutual Automobile Insurance Company
One State Farm Plaza
Bloomington, IL 61710**

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EXAMINATION REPORT
as of
June 30, 2004**

Examination Performed by

**Stephen E. King, CIE
Jo-Anne G. Fameree, CIE, FLMI, AIRC, ACS**

Independent Market Conduct Examiners

March 10, 2005

The Honorable Doug Dean
Commissioner of Insurance
State of Colorado
1560 Broadway, Suite 850
Denver, Colorado 80202

Commissioner Dean:

A market conduct examination of the State Farm Mutual Automobile Insurance Company was conducted in accordance with and pursuant to §§10-1-203 and 10-3-1106, Colorado Revised Statutes. Initially, this examination focused on the Company's Medicare supplement and Long-term Care insurance business, as well as the Company's claims practices relating to their (CY) Hospital Surgical and (DJ) Hospital Income business. The Medicare supplement and Long-term Care reviews included underwriting, rating, policyholder services, producer licensing and compensation, marketing, sales and claims practices.

Lastly, the scope of the examination was expanded to include a review of the Company's handling of automobile claims, focusing only on claims that involved vehicles that were determined to be total losses.

The Company records were examined at their offices located at 1555 Promontory Circle, Greeley, Colorado 80638.

The time period covered by the health portion of the examination was from July 1, 2003 through June 30, 2004 and the automobile claims portion was from October 1, 2003 through March 31, 2004.

The results of the examination, herein, are respectfully submitted.

Stephen E. King, CIE

Jo-Anne G. Fameree, CIE, FLMI, AIRC, ACS

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EXAMINATION REPORT
OF THE
STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY**

TABLE OF CONTENTS

<u>SECTION</u>	<u>PAGE</u>
I. COMPANY PROFILE	2
II. PURPOSE AND SCOPE OF EXAMINATION	7
III. EXAMINERS' METHODOLOGY	9
IV. EXAMINATION REPORT SUMMARY	13
V. EXAMINATION REPORT SUBMISSION.....	14

COMPANY PROFILE

State Farm Mutual Automobile Insurance Company (“State Farm Mutual” or “Company”) was incorporated in Illinois on March 29, 1922, and commenced business on June 7th, that same year. The Company received its Certificate of Authority in Colorado on May 19, 1927.

State Farm Mutual is a member of the State Farm Group, whose home office is located in Bloomington, Illinois. The other group members include State Farm Fire and Casualty Company, State Farm County Mutual Insurance Company of Texas, State Farm Indemnity Company, State Farm Life and Accident Assurance, State Farm Life Insurance Company, State Farm Florida Insurance Company and State Farm General Insurance Company.

COMPANY OPERATIONS AND MANAGEMENT

State Farm Mutual is licensed in all states, the District of Columbia and Canada for the provinces of Alberta, New Brunswick and Ontario.

The State Farm Group offers multiple lines of property & casualty and life & health insurance throughout the United States and Canada, through its exclusive agency force.

In 2003, the Company’s Medicare supplement business represented a 1.84% * share of the Colorado Medicare supplement insurance market, with direct premium totaling \$2,641,000 *; its Long-term Care business represented a 2.46% * share of the Colorado Long-term Care insurance market, with direct premium totaling \$3,103,000 *; its Accident and Health business represented a 2.16% * share of the Colorado Accident and Health insurance market, with direct premium totaling \$14,602,000 *; and its private passenger automobile business represented a 21.39% * share of the Colorado private passenger automobile insurance market, with direct premium totaling \$619,503,000 *.

* Data as reported by the NAIC and published as the “Combined Market Share Report”.

PURPOSE AND SCOPE OF EXAMINATION

Independent Examiners, contracting with the Colorado Division of Insurance (DOI), in accordance with Colorado Insurance Laws, §§ 10-1-201, 10-1-203 and 10-1-204.C.R.S., which allows the Commissioner discretion and authority to schedule and conduct examinations for the purpose of auditing business practices of insurers, reviewed certain business practices of the State Farm Mutual Automobile Insurance Company. The findings in this report, including all work products used to develop and produce this report, are the sole property of the Colorado Division of Insurance.

The purpose of the examination was to determine the Company's compliance with Colorado insurance laws related to Medicare supplement insurance, Long-term Care insurance and Hospital Surgical and Hospital Income claims handling. Additionally, automobile claims handling, dealing specifically with total loss was reviewed. Examination information contained in this report should serve only that purpose. The conclusions and findings of this examination are public record. The preceding statements are not intended to limit or restrict the distribution of this report.

Examiners conducted the examination in accordance with procedures developed by the Colorado Division of Insurance, based on model procedures developed by the National Association of Insurance Commissioners. For the health portion of the examination, Examiners relied primarily on records and materials maintained by the Company, generally covering the examination period from July 1, 2003 through June 30, 2004. For the automobile claims portion of the examination, Examiners relied primarily on records and materials maintained by the Company, generally covering the examination period from October 1, 2003 through March 31, 2004.

The examination included review of the following:

- Company Operations / Management
- Marketing and Sales
- Producers
- Underwriting - Forms / Policyholder Services
- Underwriting - Rating
- Underwriting - Applications
- Underwriting - Cancellations
- Claims

This examination report is a report written by exception. References to any practices, procedures or files, that contained no improprieties, were omitted. Therefore, the majority of the material reviewed may not be addressed in this report. In the course of the examination, Examiners provided the Company with Examination Memorandums and Comment Forms to obtain information ask questions and/or address noted discrepancies. When Examiners issue either form, the Company is required to provide a detailed response. Generally, only the Comment Form will cite a specific statute or regulation when a potential non-compliant situation is identified.

In most cases, an error tolerance level of plus or minus ten dollars (\$10.00) was allowed where monetary values were involved. However, in cases where monetary values were generated by computer or other systematic methodology, a zero (\$0) tolerance level was applied in order to identify possible system errors. Additionally, a zero (\$0) tolerance level was applied in instances where there appeared to be a consistent pattern of deviation from the Company's established policies, procedures, rules and/or guidelines.

When utilizing a sampling technique to select a sample file population for review, a minimum error tolerance level of five percent (5%) was established to determine reportable exceptions. However, if an issue appeared to be systemic or if, as a result of the file selection process, it was not possible to determine an exception percentage, an error tolerance percentage was not utilized. Also, if more than one sample population was reviewed in a particular area of the examination (e.g. timeliness of claims payment), and if one or more of the samples yielded an exception rate of five percent (5%) or more, the results of any other samples with exception percentages less than five percent (5%) were also included.

Examination findings may result in administrative action by the Division of Insurance. All unacceptable or non-complying practices of the Company may not have been discovered during the examination, however, failure to identify such practices does not constitute acceptance. The contents of this report should not be interpreted to either endorse or discredit any insurance company or product.

EXAMINERS' METHODOLOGY

In accordance with §10-1-203, Colorado Revised Statutes, examiners reviewed the Company's business practices to determine compliance with Colorado insurance laws and regulations, as they pertain to Medicare supplement and long-term care insurance business and specifically claims practices, as they pertain to hospital surgical and hospital income business, as shown in the following exhibit.

Exhibit 1

Law/Regulation	Concerning
Section 10-1-108	Duties of Commissioner – reports – publications – fees – disposition of funds - adoption of rules.
Section 10-1-109	Rules and regulations of commissioner
Section 10-1-111	Grounds and procedure for suspension or revocation of certificate or license of entities.
Section 10-1-128(6)(a)	Anti-fraud Plan
Sections 10-2-1001 to 10-2-1101	Managing General Agent Act
Section 10-2-103	Licenses - General Provisions - Definitions
Sections 10-2-401 to 10-2-417	Licenses – Licensing and Appointment of Insurance Producers
Sections 10-2-701 to 10-2-704	Licenses – Business Conduct of Licensees
Section 10-3-105	Certificate of Authority
Section 10-3-109	Reports, statements, assessments, and maintenance of records - publication - penalties for late filing, late payment, or failure to maintain.
Sections 10-3-1101 to 10-3-1104	Unfair Competition – Deceptive Practices
Sections 10-18-101 to 10-18-109	Medicare Supplement Insurance
Sections 10-19-101 to 10-19-115	Long-term Care Insurance Act
Regulation 1-1-7	Market Conduct Record Retention
Regulation 1-1-8	Penalties And Timelines Concerning Division Inquiries And Document Requests

Law/Regulation	Concerning
Regulation 1-2-9	Fees Charged by Agents/Brokers
Regulation 2-1-7	Concerning Issuance of a Certificate of Authority
Regulation 4-3-1	Minimum Standards for Medicare Supplement Policies
Regulation 4-4-1	Concerning Requirements for Long-term Care Insurance
Regulation 4-4-2	Implementation of Basic and Standard Long-term Care Insurance Plans
Regulation 4-4-3	Suitability Standards for Long-term Care Insurance Products

Company Operations / Management

Examiners verified the Certificate of Authority and reviewed Company management, administrative controls and record retention practices.

The Company's cooperation during the course of the examination was noted.

Marketing and Sales

Examiners selected sample populations of fifty (50) Medicare supplement marketing and sales pieces and fifty (50) Long-term Care marketing and sales pieces from populations of sixty-one (61) and 161, respectively. Additionally, Examiners reviewed the entire Company website as it appeared during the examination period. Examiners verified that all materials required to be submitted, were submitted to the Colorado Division of Insurance. The content of the marketing and sales material was reviewed to ensure compliance with Colorado insurance law and to verify that the Company's products were accurately represented.

Producers

Examiners reviewed producer contracts and commission structures used during the examination period for both Medicare supplement and Long-term Care. In addition, commission records for both lines of business were reviewed to ensure that all producers receiving commissions, or a percentage of premiums, were properly licensed.

Underwriting – Forms / Policyholder Services

Examiners reviewed all forms used during the examination period, as provided by the Company, to ensure that the Company met the mandated form, filing and certification requirements, as required by Colorado insurance law.

New Business Underwriting Practices and Rating

Examiners randomly selected sample populations of fifty (50) Medicare supplement new business files and fifty (50) Long-term Care new business files, from populations of 350 and 422, respectively. Additionally, Examiners selected a sample population of fifty (50) Medicare supplement renewed business files from a population of 1,667.

Each file was reviewed to ensure that required disclosures were provided and fair and consistent underwriting and rating practices were used.

Underwriting – Cancellations / Declinations / Rescissions

Examiners randomly selected sample populations of fifty (50) Medicare supplement (policyholder requested) cancellation files, and fifty (50) Long-term Care (policyholder requested) cancellation files, from populations of 137 and eighty-nine (89), respectively. One (1) Long-term Care file, rescinded

during the examination period, was reviewed. The Company had no declinations of Medicare supplement or Long-term Care business, during the examination period.

Each file was reviewed to ensure that both fair and consistent underwriting practices were used, timely notifications were given and, when applicable, premium refunds were timely and accurate.

Claims

Examiners randomly selected sample populations of 100 Medicare supplement and fifty (50) Long-term Care paid claims files, from populations of 56,762 and 213, respectively. Examiners also selected a sample population of fifty (50) Medicare supplement denied claim files from a population of 153. All thirty (30) Long-term Care files, denied during the examination period, were reviewed.

Examiners randomly selected sample populations of 100 (CY) Hospital Surgical paid claims files and fifty (50) (DJ) Hospital Income paid claims files, from populations of 8,257 and 1,753, respectively. Also, Examiners randomly selected sample populations of fifty (50) (CY) Hospital Surgical denied claims files and fifty (50) (DJ) Hospital Income denied claims files, from populations of 4,851 and 243, respectively.

Lastly, Examiners randomly selected a sample population of fifty (50) private passenger automobile total loss claims files, from a population of 1,658. Before selection of the sample, the population data file was “modified” to include only total loss claims involving vehicles that were six (6) years old and newer since the focus of this portion of the exam was on the company’s handling of total loss vehicles that are subject to the Colorado’s salvage title requirements. (Colorado’s salvage title requirements do not apply to vehicles more than six (6) years old at the time of damage.)

Examiners reviewed the Company’s claims handling guidelines, as well as pertinent claim file information, to determine timeliness of processing, accuracy of payment, and whether proper disclosure was made regarding the damage that resulted in the determination that the vehicle was a “total loss”.

EXAMINATION REPORT SUMMARY

The examination resulted in zero (0) findings, in which the Company did not appear to be in compliance with Colorado insurance law.

Results of previous Market Conduct Exams are available on the Colorado Division of Insurance's website at www.dora.state.co.us/insurance or by contacting the Colorado Division of Insurance.

Independent Market Conduct Examiners

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